

# The taxation of sukuk in the Italian context: is Italy's tax system ready for Islamic financial instruments?

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**Abstract— This article is focused on the tax treatment of sukuk, one of the most important financial instruments compliant with Shariah principles. In the first part, the Authors make a brief analysis of EU countries that have adopted specific legislative or regulatory measures to solve some tax critical points that usually discourage the use of the sukuk. In the second part, these financial instruments are examined from an Italian income tax standpoint. The analysis is conducted not only in light of current tax legislation and praxis but also with reference to possible future developments. In this perspective, the Authors examine some critical issues such as the lack of guidelines coming from the Italian Tax Authorities and the uncertainties on the application of the Italian general anti avoidance rule.**

**Keywords-** sukuk; taxation; financial instruments; Italy

## I. INTRODUCTION

Among the Islamic finance, sukuk undoubtedly constitute the “crown jewels”, because such instruments create a framework for participation of a large number of people in financing project in public and private sectors according to various models and structures [1].

In general terms, sukuk (which is the plural form of *sakk*, certificate) are Islamic financial certificates that complies with *Shariah* principles and laws. Investment sukuk, as defined by AAIOFI, are the certificates of equal value representing undivided shares in ownership of tangible assets, usufruct and services or (in the ownership of) the assets of particular projects or special investment activity.

Even if sukuk are often defined as “Islamic bonds”, it must be pointed out that their structure differs from a typical bond structure. In fact, the definition above includes two important points:

- a) sukuk holders must have the ownership of the asset of the specific project, and
- b) the project and the sukuk issuance procedure must be consistent with *Shariah* principles.

Furthermore, in order to understand the basic functioning of sukuk at least five *Shariah* principles must be taken into account [2]:

1. the prohibition of *Riba* interest, *i.e.* any added amount paid, as cost of borrowing, by the borrower to the lender more than the principal amount. This principle implies that a sukuk cannot have the “typical” bond structure, because of the prohibition of interest repayments to the lender; in fact, according to *Shariah*, money is just a mean of exchange and has no intrinsic value, so an individual or an institution should not be able to generate income from money;

2. the prohibition of *Gharar*, *i.e.* uncertainty or speculation. The trading under uncertainty in financial transactions is not allowed, but risk-taking is allowed when all terms and conditions are clearly stipulated and known to all parties;

3. the use of asset-backing, *i.e.* each financial transaction must relate to a tangible and/or identifiable underlying asset, ensuring that Islamic banks remain connected to the real economy. In this perspective, sukuk can be divided in two main categories: asset-based sukuk and debt-based sukuk. Only the former can be tradable, while the latter are not tradable (except on par value, with no profit for the seller);

4. the prohibition of *Haram* investments, *i.e.* any transaction that involve alcohol, pork, prohibited drugs, and pornography;

5. the prohibition of *Maysir*, *i.e.* all transactions that have the element of gambling and are based merely on chance are not allowed.

According to recent information, Italy would soon enter in the Islamic Finance (IF) market, and the Italian Parliament is going to discuss a proposed legislation on sukuk that might allow a significant development in the use of such instruments, which at the moment are limited by the financial legislation (and by some tax issues, as described below) [3].

As a consequence, it is particularly important to examine the Italian tax framework potentially applicable to sukuk, also in connection with the systems of some EU Member States which have already implemented guidelines or rules concerning such instruments.

In the following paragraphs the aforementioned aspects are be examined, firstly with a brief analysis of EU countries that

have been adopted specific actions (legislative or regulatory) in order to set out a general perspective for the taxation of sukuk, then particular attention is paid to the Italian situation, also with reference to possible future development<sup>1</sup>.

## II. TAXATION OF SUKUK AMONG THE EU: A “CONDITIONED” SUBSTANTIAL APPROACH

From a tax standpoint, the analysis of the sukuk treatment mainly concern two aspects:

- a) the taxation of the sukuk remuneration in the hands of the holder, and
- b) the deductibility of the sukuk remuneration paid by the sukuk issuer.

In fact, from a tax perspective, the treatment of interest and dividends is very different, due to the fact that, in general terms, the former are deductible from the taxable income of the payer and taxed in the hands of the recipient, while the latter are not deductible for the payer and they are taxed (even if with particular mechanisms in order to avoid double economic taxation, such as total or partial exemption) in the hands of the recipient.

Nevertheless, for some hybrid financial instruments there is also a mismatching problem. In fact, in case an instrument is considered by the legislation as a share for the issuer and as an obligation by the holder, it is possible that the remuneration would be non-deductible (as it is considered similar to a dividend) for the former and taxed as an interest from the latter. On the contrary, there would be also the non-taxation case, e.g. a remuneration that is deducted as an interest by the payer, and it is fully or partially tax exempt (as a dividend) in the hands of the recipient.

In light of the cases above, it is crystal clear the reason why some countries have issued specific rules and criteria in order to clarify the tax treatment of sukuk, also because the uncertainties in the taxation of such instrument could represent a significant obstacle to their development.

In this respect, it is noteworthy to remark that two approaches can be recognized among European countries that have explicitly addressed the taxation of Islamic finance.

The first approach consists in providing only some clarification by the tax authorities, without issuing or modifying the relevant legislation on taxation of financial instruments, such as in Luxembourg and France.

With reference to Luxemburg, tax authorities admit that, if an income is substantially an interest, such income may be taxed according to its economic nature, i.e. as an interest, despite its legal form, only if certain conditions are met<sup>2</sup>.

<sup>1</sup> Please note that the following analysis relates only to direct taxation aspects from an Italian and comparative standpoint. Also, cross-border issues are not considered.

<sup>2</sup> In particular, this approach is allowed only if all the following conditions are met:

France has also adopted tax measures to promote Islamic finance. In 2009 French tax administration issued five Guidelines [5], which tend to make sukuk comparable to conventional bonds, and the remuneration paid to the holder comparable to interest, if certain conditions are met<sup>3</sup>. After this first Guidelines, the French Tax Administration has put in place an industry consultation and has updated the criteria provided with the aforementioned document in 2010<sup>4</sup>; some further clarifications have also been provided in 2012 [8].

The second approach consists in adopting an *ad hoc* legislation on Islamic finance and sukuk, with significant innovations and modifications to the relevant tax rules. This approach has been followed by countries such as United Kingdom and Ireland.

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- the contract between the parties must clearly demonstrate that the financier acquires the property to resell it, concurrently or within a period not exceeding six months, to his client;
  - the contract must show separately the remuneration of the financier as a result of his intermediation, the benefit of the financier constituting the consideration for a deferred payment, the purchase price by the customer and the purchase price of the asset by the Financial resources;
  - the benefit of the financier must be clearly explained, known and accepted by both parties to the contract;
  - the benefit of the financier must be expressly designated as the consideration for the service rendered by the financier to the customer and which results from the actual deferral of payment made to the investor. For example, it may be a clause presenting the profit as "the consideration for the deferred payment granted to the buyer by the seller, the buyer undertaking to pay the seller the profit until the date of Final reimbursement ";
  - as for the accounting and tax treatment, the profit must be spread by the financier on a straight-line basis over the deferred payment period, regardless of the repayments made [4].

<sup>3</sup> More in detail, if all the following conditions are met, sukuk could be considered to be debt instruments and the remuneration could be deductible the taxable income of the issuer:

- (i) sukuk should entitle their owners to be reimbursed before the shareholders of the issuer;
- (ii) sukuk should not grant any voting right or any right in the liquidation profits to them;
- (iii) the amount of the remuneration paid to investors should be based on the underlying asset and remain limited to a market rate with a markup;
- (iv) the reimbursement of sukuk may be partial [6].

<sup>4</sup> Guideline 4 FE/S2/10 of 24th August 2010. The 2010 Guidelines analyze a specific type of sukuk, the sukuk *ijara* (i.e., the sukuk involving the lease of an asset), and they adopt the same approach of the 2009 Guidelines. More in detail, according to the 2010 Guidelines the income distributed to sukuk *ijara* holders is considered interest income if the sukuk *ijara* qualifies as a debt instrument under French tax law, and a sukuk *ijara* will qualify as a debt instrument for French tax purposes only if

- the holders are repaid in the event of liquidation or insolvency proceedings before the partners/shareholders and equity holders of the issuing entity;
  - the holders do not benefit from the rights generally attributed to shareholders and as such have neither voting rights nor rights to a liquidation dividend in the event of the liquidation or winding up of the issuing entity (except in the event where the sukuk *ijara* would be converted into equity rights);
  - the income received by the holder depends on the revenues generated by the financed assets or the results of operations of the issuing entity, but this income must be capped at a recognized market rate (Euribor, Libor, etc.) plus a determinable margin. The income distributed to the holders may be nil depending on the profits of the issuing entity or the return on the assets. However, an income target may be specified to the holders; and
  - the principal of the sukuk *ijara* may be repaid only in part in the event where the value of the financed assets has fallen, but the right to the repayment of the principal may only be reduced proportionally to this decline in asset value.
- On the contrary, if one or more of the previous conditions were not met, the sukuk *ijara* would qualify as an equity instrument, and consequently the remuneration paid to the holder would be deemed be a dividend [7].

As for United Kingdom, the UK legislation has adopted *ad hoc* tax rules generally based on the substance, rather than on legal form. An update of the legislation was necessary due to the absence of a doctrine on substance-over-form in UK tax law: in fact, such country generally taxes transactions according to their legal form “so the legal manner in which a transaction is structured and documented determines the taxation of that structure, unless there is a specific statutory provision to the contrary” [9].

Such rules establish a category of transactions called “alternative finance arrangements” which embraces sukuk and several other transactions (*murabaha*, *mudaraba*, *musharaka* and other financial structures). In order to avoid abuses, these provisions are used in duly substantiated cases, in which the borrower effectively receives financial funding from a bank or by a person duly authorized to carry out lending activities.

The corollary of this substance-over-form principle entails that the proceeds from the Islamic finance transactions are treated, for tax purposes, in the same way as interest paid in consideration of a loan<sup>5</sup>. In fact, also in the UK tax system, provided that certain conditions are met a sukuk is treated as a security for corporation and income tax purposes<sup>6</sup>.

<sup>5</sup> Changes in the UK legislation have been implemented by stages. The first significant change happened in 2003: the Finance Act 2003 introduced some reliefs in order to prevent multiple payment of Stamp Duty Land Tax on Islamic mortgages. Afterwards, the Finance Acts 2005 and 2006 have been implemented further measures directed to put other Islamic products on the same tax footing as their conventional counterparts. Moreover, the Finance Act 2007 has clarified the tax framework of sukuk.

In particular, the Section 53 of the Finance Act 2007 provides that the payments made by a customer to a sukuk issuer, other than the amounts paid for the customer’s gradual acquisition of the beneficial interest in the property, is treated as an alternative finance return and consequently taxed as interest.

This puts this financial instrument in the same position of a classical securitization, because the withholding tax is not applicable.

In particular, the proceeds deriving from *murabaha* operations shall qualify as income assimilated to the interests (and subjected to the same tax regime), as fruits resulting from commissioning available to an economic capital, rather than the same way as capital gains. Same treatment is provided to income arising from operation of *mudaraba*, which, although resulting from a form of joint venture, are not treated as dividends or profits from investments, but also fall between the income and similar interests. The tax assimilation is now complete, because to incomes from Islamic finance are subjected to the same provisions concerning similar financial instruments and involving withholding taxes, transfer pricing, etc. [10].

<sup>6</sup> In particular, those provisions apply to arrangements if:

- they provide for a person (the holder) to pay a sum of money (the capital) to another (the issuer);
- they identify assets, or a class of assets, that the issuer will acquire to generate income or gains directly or indirectly (the bond assets);
- they have a specified life (the bond term);
- the issuer undertakes to: dispose at the end of the bond term of any bond assets which are still in the issuer’s possession; make a repayment of the capital (the redemption payment) to the holder during or at the end of the bond term (whether or not in instalments); and pay to the holder other amounts on one or more occasions during or at the end of the bond term (additional payments);
- the additional payments do not exceed a reasonable commercial return on a loan of the capital;
- the issuer arranges for the bond assets to be managed with a view to generating income sufficient to pay the redemption payment and the additional payments;

Ireland has also introduced a specific legislation concerning sukuk and other transaction (*murabaha*, *musharaka*, and *mudaraba*). More in detail, the Finance Act 2010 has provided that, with reference to sukuk, the investment return will be treated for purposes of Irish tax law as if it was interest on a security, and the investment return will be charged to tax accordingly, only if certain conditions are met [12].

In light of the above, both with reference to the taxation of sukuk in the hands of the holder and to the tax deductibility of the sukuk remuneration paid by the issuer, the main issue in all the countries which address this topic seems to be whether, and under which circumstances, the economic substance or the juridical form prevails.

In the above-mentioned countries, the prevailing approach seems to be a “conditioned” substantial approach. In other words, those countries generally allow a substance-based taxation of IF instruments (also because a taxation based merely on the legal form is seen as potentially distortive) but only if certain conditions are met, in order – mainly – to prevent possible tax avoidance by the abuse of this approach and to avoid (positive or negative) discriminations among financial instruments.

From an Italian standpoint, bearing in mind that no clarification has been given so far on IF instruments (neither from the tax administration nor via *ad hoc* legislation), the general rules on taxation of financial instruments would apply. As a consequence, in the next paragraphs the Italian tax treatment of financial instrument issuers and holders is examined, in order to point out some considerations about the taxation of sukuk in such context.

### III. THE ITALIAN TAX FRAMEWORK FOR FINANCIAL INSTRUMENTS

As mentioned above, while several European jurisdictions, as described in the previous paragraph, have taken actions to encourage the development of *Shariah*-compliant transactions also by means of a non-discriminating tax framework<sup>7</sup>, Italy has not adopted so far neither specific legislative provisions nor explicit clarifications (in form of circular letter or resolutions) by tax administration, even if a law proposal has been recently filed with the Italian Chamber of Deputies [14]. Therefore, from an Italian perspective the tax treatment of sukuk must be determined according to the general rules applicable to financial instruments [15].

While other tax systems (such as Anglo-Saxon and Northern Europe countries) provide for a unique income category of financial income, without any further division or partition [16], under the Italian income tax code (*Testo unico*

- the holder is able to transfer its rights under the arrangements to another person (who becomes the holder as a result of the transfer);
- the arrangements are listed on a recognized stock exchange; and
- the arrangements are treated in accordance with international accounting standards, wholly or partly, as a financial liability of the issuer [11].

<sup>7</sup> Different jurisdictions have taken action in order to enable the execution of transactions in line with the dictates of *Shariah* through the preparation of a favorable regulatory framework, both in legal and tax. The UK was the first European jurisdiction to adapt its tax legislation in order to allow the execution of transactions in line with the precepts of *Shariah* [13].

delle imposte sui redditi, TUIR) taxation of financial income for non-business subjects is based on two income categories, depending on the “static” or “dynamic” use of capital. More in detail, the first is considered “investment income” or “income from capital” (*redditi di capitale*), and it includes all the income derived by a mere “static” use of the capital, as interest and dividends, in which the remuneration is the consequence of the productivity of the capital. On the other hand, the “dynamic” use of capital refers to those cases in which the emersion of positive or negative differences in dependence on an uncertain event is possible, such as capital gains and losses (Art. 44, par. 1, letter h, TUIR).

On the contrary, for business entities income from capital and capital gains/losses are generally included in the determination of the taxable income, as all the income derived in a business activity is considered business income and it is subject to corporate income tax.

In light of the considerations made above, the main issue seems mostly related to the investment income category, due to the fact that from tax purposes it is crucial to ascertain when, and under which conditions, a sukuk remuneration is considered as a dividend or as an interest, and the criteria for the deductibility of the sukuk remuneration from the issuer’s taxable income.

#### A. Taxation of investment income: interest versus dividends

This category includes both income from investment in companies and other entities (such as dividends) and interest and other income arising from loans and other forms of capital deployment (obligations, bonds, certificates, etc.).

The determination of the taxable income for such category is based on two main principles: non-deductibility of the production expenses (e.g., bank fees) or capital losses, and taxation at the time of the receipt and not on an accrual basis (i.e., income is taxed only at the time of the payment in the hands of the securities holder). However, apart from the two general principles above, it is worth noting that, even if interests and dividends are included in the same income category, they are subject to tax according different rules.

More in detail, dividends derived by individual shareholders are subject to tax depending on whether the participation is held in a business capacity or not.

In the first case, such dividends are exempt for 50.28%, and they are subject to individual income tax (*Imposta sul reddito delle persone fisiche*, IRPEF) at a progressive tax rate<sup>8</sup> only for the 49.72% of the amount, irrespective to the percentage of the voting power or of the capital owned in the company.

On the contrary, in the second case (i.e., individual shareholders not holding the participation in a business

capacity) the tax treatment depends on the percentage of voting power and/or the capital owned by the shareholder:

a) if the shareholder owns more than 20% of the voting power (2% for listed companies) or 25% of the capital (5% for listed companies), the same regime of partial exemption above described would apply;

b) if the shareholder owns less than the percentages mentioned in the previous point, dividends distributed are subject to a 26% final withholding tax.

As for interests arising from loans and other forms of capital deployment, they are generally subject to a 26% final withholding tax (Article 26 of the Presidential Decree n° 600/1973 and Law Decree n° 66/2014)<sup>9</sup>.

Furthermore, specific rules apply to hybrid securities. From a tax perspective, it must be ascertained if a hybrid security can be included into one of the following type:

a) *financial instruments similar to shares*, if their remuneration is totally linked to participation to the economic results of the issuer. In that case, the proceeds are treated as dividends in the hands of the recipient, while for the issuer the remuneration paid would be non-deductible as it is considered similar to a distribution of profits to shareholders (Article 44, par. 2, letter a, TUIR);

b) *financial instruments similar to bonds*, if the issuer has an unconditional obligation to pay at maturity an amount not less than that amount received for the subscription, and if the holder has no direct or indirect participation in the management or control of the business or the deal for which such securities have been issued (Art. 44, par. 2, letter c, n° 2, TUIR).

In case a hybrid security cannot be included in one of the two categories above, it is classified among the so-called “atypical securities” (*titoli atipici*), if the dependence on the financial results of the issuing company is partial, and so they are neither shares (or similar to shares) nor bonds (or similar to bonds) (Article 5 of Law Decree 30 September 1983 n° 512). The proceeds deriving by such financial instruments are subject to a 26% final withholding tax.

Furthermore, for corporation and business entities, interest and dividend received are included in the determination of the taxable income, as according to article 81, TUIR all the income derived in a business activity is included in the business income and it is subject to corporate income tax (*Imposta sul reddito delle società*, IRES, whose current rate is 24%). However, while interest expenses are fully taxed (on an accrual basis) in the hands of the recipient, dividends and other income from financial instruments similar to shares<sup>10</sup> that are not

<sup>8</sup> The IRPEF rates are the following (art. 11, TUIR):

- Up to EUR 15,000: 23%
- From EUR 15,001 to EUR 28,000: 27%
- From EUR 28,001 to EUR 55,000: 38%
- From EUR 55,001 to EUR 75,000: 41%
- Over EUR 75,000: 43%

<sup>9</sup> Moreover, a reduced rate (12.5%) would apply to bonds issued by the Italian government, EU Member States or states that allow an adequate exchange of information with the Italian tax authorities.

<sup>10</sup> This treatment also applies to

- remuneration on securities, financial instruments and contracts of silent partnership or joint ventures, limited to 95% of their non-deductible portion;
- remuneration on securities and financial instruments, even not similar to shares but to the extent they are not deductible in the hands of the issuer,

considered equity-like securities for tax purposes, and to the extent that they are not deductible in the hands of the issuer, are 95% exempt, and so they are generally subject to tax (at the time of the payment) only on 5% of the amount received (Article 89, TUIR).

#### B. The deductibility of the remuneration paid by the issuer

As mentioned in the previous paragraphs, also in the Italian tax system dividends are not deductible from the taxable income, while interests are in principle deductible, even if certain limitations would apply.

To this extent, TUIR provides that is not deductible any kind of remuneration due on securities and financial instruments, for the portion of it that directly or indirectly involves the participation to the economic results of the issuer or other companies in the same group, or the specific business activity for which the financial instruments were issued (Article 109, par. 9, letter a, TUIR).

On the contrary, interest expenses are in principle deductible from the payer's taxable income, although some limitations apply. In particular, for corporate entities interest expenses are fully deductible up to an amount equal to interest income accrued in the same tax period, but the excess over that amount is deductible, in brief, to the extent of 30% of the company's earnings before interest, taxes, depreciations and amortizations (EBITDA). Any excess of interest expenses over the 30% of EBITDA may be carried forward for deduction in the following tax periods, and it would be deductible if interests in such tax periods are less than 30% of EBITDA (unless some cases in which happens a change of control and/or the company's business purpose)<sup>11</sup>.

Furthermore, it is important to remark that interest paid by banks and other financial institutions are fully deductible, while interest paid by insurance companies, parent companies of insurance groups and qualifying investment fund management companies are deductible up to 96% of their total amount.

#### IV. THE TAX FRAMEWORK FOR SUKUK HOLDERS IN THE ITALIAN CONTEXT

In light of the Italian tax framework for financial instruments described above, it is possible to point out some considerations on the tax treatment of sukuk based on the aforementioned general principles and rules.

In this respect, a sukuk can produce in principle two types of income:

a) income from capital, as for the remuneration (periodic or not) derived by the capital contribution made by the sukuk holder;

b) capital gain/loss (as "miscellaneous income of financial nature") as for the proceed deriving from the sale, the disposal or the redemption of sukuk<sup>12</sup>.

The main tax issues of sukuk seem to be related to the qualification of their remuneration among the investment income category, so it is noteworthy to focus on the letter (a) above, *i.e.* if the remuneration of the capital contribution can be qualified as an interest, as a dividend or as a profit from "atypical security", as defined by the Italian tax rules.

As briefly mentioned before, the prohibition of *Riba* imply that interest is necessarily replaced with a profit and a loss-sharing principle, so it means that any remuneration must be earned from an effective commercial trading. Furthermore, there is no guarantee on the return, because risk and profit must be shared equally between the parties of the transaction.

It is noteworthy to remark that the Italian rule described above consider as non-deductible those proceeds paid in connection with a (direct or indirect) participation to the economic result of the issuer and/or a specific activity carried out, because such proceeds are considered as dividends for the issuer.

This criterion can be a serious obstacle to the deductibility of the remuneration paid with reference to the sukuk in the Italian context, because, to the extent that sukuk do qualify as "*undivided shares in ownership of tangible assets, usufruct and services or (in the ownership of) the assets of particular projects or special investment activity*", as defined by AAIOfI, the proceeds paid in connection with sukuk could be considered non-deductible because they represent a participation to the issuer's results or in a specific activity. In this perspective, such remuneration would be taxed as a dividend in the hands of the sukuk holder, and so it can be partially (or almost fully, in case of intercompany payments) exempt for the recipient.

However, it must be also taken into account that in some cases even financial instruments linked to the economic results of the issuer are not considered similar to shares and consequently their remuneration is deductible as an interest for the issuer (and taxed accordingly for the recipient). This is the case, for example, of those instruments whose yield is predetermined at a certain rate, but the perception of the remuneration depends on the existence of profits or on the actual distribution of dividends by the issuer.

Also, it must not be *a priori* excluded that, even if the legal form of some Islamic finance structures does not allow the payment of an interest to the lender, from a substantial standpoint the remuneration could be structured in order to be a *de facto* interest, at least from a tax standpoint, and so it would be subject to tax accordingly.

Therefore, as a conclusive remark, even if at first glance – due to their definition itself – sukuk seem to be included among the financial instruments similar to shares from an Italian tax standpoint, a deeper analysis is required in order to

limited to 95% of the (possible) quota corresponding to the participation to the economic results of the issuer.

<sup>11</sup> For taxpayers subject to IRPEF (individuals acting in a business capacity and partnerships) such limitation does not apply, while interest are deductible only if they are related to the business activity and to the extent of the ratio between taxable revenues and total revenues.

<sup>12</sup> In case this gain cannot be regarded as an income from capital, as for instance in a zero coupon bond structure.

determine the correct qualification of such instrument in the tax legislation applicable to the issuer and to the holder.

## V. CONCLUSIVE REMARKS

In light of the analysis made in the previous paragraphs, it is clear that in order to classify a sukuk as similar to shares or not, it must necessarily be taken into account not only the legal form of the financial instrument, but also the economic and financial effects for the issuer and the holder.

In this perspective, it can be said that Italian tax legislation has already a rather substantial approach for all financial instruments, so the introduction of sukuk as a “new” (at least, for the Italian system) category of financial instruments should follow the same criteria provided for the other financial instruments.

This does not necessarily mean that a possible introduction of sukuk would be “plain vanilla” for the Italian tax context. Even if the substantial effects of the financial instruments are considered in order to determine the appropriate taxation, it is worth noting that several classification problems for hybrid financial instruments still remain in the Italian tax system, due to, for example, the lack of sufficient official guidelines.

This uncertainty can constitute an obstacle to the IF development in Italy, also because the Italian tax administration could have the power to recharacterize one or more transactions (including sukuk) in case it does not agree with the qualification given by the sukuk issuer/holder (e.g., the issuer considered that the remuneration is not linked to its economic results, while tax authorities considered that it is).

Moreover, tax authorities can also recharacterize one or more transactions when they fall within the scope of the general anti avoidance rule contained in article 10-*bis* of Law 212/2000, according to which one or more transactions can constitute “abuse of law” if they are formally consistent with tax law but there is no economic substance, *i.e.* they don't generate significant effects other than tax savings and they are not justified by valid and non-marginal non-tax reasons. In this perspective, it would be interesting to determine if non-tax reason different from economic reason, such as the compliance with *Shariah's* principles and laws, could be considered non-marginal reasons which are suitable to justify a deviation to the “normal” juridical form and consequently do not lead to an “abuse of law”.

With reference to possible future developments from a tax standpoint, as mentioned in the first paragraph, a law proposal on Islamic finance has recently been presented to the Chamber of Deputies; such proposal considers the tax treatment of certain transactions (in particular, *murabaha*, *ijara* and *istisna'a*) and also addresses the tax issues related to sukuk. If the aforementioned proposal will be approved by the Italian Parliament, it is undoubtedly going to remove some uncertainty in the field of the taxation of these financial instruments.

In the meantime, or in case the future legislation on sukuk will not explicitly address all the relevant tax aspects, in order to clarify the Italian tax treatment for a possible sukuk transaction and remove all the related uncertainties, one

possibility for the parties involved in a sukuk transaction can also be the submission of a tax ruling request to the tax administration, also because the interpretation provided is binding on tax authorities and consequently all the tax issues could be solved in advance<sup>13</sup>.

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<sup>13</sup> The answer from the Italian tax authorities generally takes 90 days.

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